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ADBE.OQ - Q3 2023 Adobe Inc Earnings Call

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## OVERVIEW:

Company Summary

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**David Wadhvani** *Adobe Inc. - President of Digital Media Business*

**Jonathan Vaas** *Adobe Inc. - VP of IR*

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## PRESENTATION

### Operator

Good day, and welcome to the Q3 FY 2023 Adobe Earnings Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Jonathan Vaas, VP of Investor Relations. Please go ahead.

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### Jonathan Vaas - Adobe Inc. - VP of IR

Good afternoon, and thank you for joining us. With me on the call today are Shantanu Narayen, Adobe's Chair and CEO; David Wadhvani, President of Digital Media; Anil Chakravarthy, President of Digital Experience; and Dan Durn, Executive Vice President and CFO.

On this call, which is being recorded, we will discuss Adobe's third quarter fiscal year 2023 financial results. You can find our press release as well as PDFs of our prepared remarks and financial results on Adobe's Investor Relations website.

The information discussed on this call, including our financial targets and product plans, is as of today, September 14, and contains forward-looking statements that involve risks, uncertainty and assumptions. Actual results may differ materially from those set forth in these statements. For a discussion of these risks, you should review the factors discussed in today's press release and in Adobe's SEC filings.

On this call, we will discuss GAAP and non-GAAP financial measures. Our reported results include GAAP growth rates as well as constant currency rates. During this presentation, except per share amounts, Adobe's executives will refer to constant currency growth rates, unless otherwise stated. Reconciliations are available in our earnings release and on Adobe's Investor Relations website.

I will now turn the call over to Shantanu.

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

Thanks, Jonathan. Good afternoon. Adobe had another record Q3, achieving revenue of \$4.89 billion, representing 13% year-over-year growth. GAAP earnings per share for the quarter was \$3.05 and non-GAAP earnings per share was \$4.09, representing 26% and 20% year-over-year growth, respectively.

Driving the success is a rich and innovative product road map. The advances we are delivering across Creative Cloud, Document Cloud and Experience Cloud are enabling us to attract an ever-growing set of users while delivering more value to existing customers. Yesterday's exciting announcements add to this road map. With the commercial availability of our generative AI capabilities, natively integrated in Adobe Creative Cloud, Adobe Express and Adobe Experience Cloud, we're unleashing a new era of AI-enhanced creativity for millions of customers around the globe.

We're bringing generative AI to life across our portfolio of apps and services to deliver magic and productivity gains. Our rich datasets enable us to create foundation models in categories where we have deep domain expertise. In the 6 months since launch, Firefly has captivated people around the world who have generated over 2 billion images. We're excited about the potential to reimagine the content supply chain for all businesses through the integration of our clouds, enabling the delivery of personalized and engaging customer experiences.

Our strategy to unleash creativity for all, accelerate document productivity and power digital businesses is driving our growth across every geography. By delivering innovative technology platforms and services, we continue to advance our industry leadership and delight a growing universe of customers.

I'll now turn it over to David to share more about our momentum in the Digital Media business.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Thanks, Shantanu. Hello, everyone.

In Q3, we achieved net new Digital Media ARR of \$464 million and revenue of \$3.59 billion, which grew 14% year-over-year, driven by strength in both our Creative and Document businesses.

On the Creative side, digital content creation and consumption are exploding across every creative category, customer segment and media type. Creative Cloud is the leading creativity platform, offering a comprehensive portfolio of products and services for every discipline across imaging, photography, design, video, animation and 3D. We're excited about the growth we're driving with our creative flagship products and with Adobe Express, our AI-first, all-in-one creativity app that makes it fast, easy and fun for any user to design and share standout content.

Yesterday's announcements highlighted several advances to our creative business.

First, after an unprecedented beta that saw over 2 billion images generated, Adobe Firefly models and the Firefly web application are now commercially available. Firefly supports text prompts in over 100 languages and enables users around the world to create content that is designed to be safe for commercial use. We will continue to train and release new Firefly foundation models in areas where we have rich data sets and expertise such as imaging, vector, video, design, 3D and more.

Second, Adobe Firefly-powered features are now natively integrated into several Creative Cloud apps, including Generative Fill and Generative Expand in Photoshop, Generative Recolor in Illustrator and Text to Image and Text Effects in Adobe Express. These deep integrations deliver more creative power than ever before to customers, enabling them to experiment, ideate and create in completely new ways.

Third, Adobe Firefly for Enterprise is now generally available for businesses to enable both creative teams and knowledge workers to confidently deploy AI-generated content. Adobe will empower customers to create custom models using proprietary assets to generate branded content and offer access to Firefly APIs so customers can embed the power of Firefly into their own content creation and automation workflows.

And finally, we announced subscription offerings, including new generative AI credits with the goal of enabling broad access and user adoption. Generative credits are tokens that enable customers to turn text-based prompts into images, vectors and text effects, with other content types to follow. Free and trial plans include a small number of monthly fast generative credits that will expose a broad base of prospects to the power of Adobe's generative AI, expanding our top of funnel. Paid Firefly, Express and Creative Cloud plans will include a further allocation of fast generative credits. After the planned specific number of generative credits is reached, users will have an opportunity to buy additional fast generative credits subscription packs.

In Q3, we added \$332 million of Creative ARR and achieved \$2.91 billion of revenue, growing 14% year-over-year.

Business highlights include: the integration of Firefly into Photoshop and Illustrator. Over 3 million users have downloaded the Photoshop and Illustrator beta releases.

The general availability of Adobe Express now includes support for editing and posting designs, videos, images, PDFs, presentations and more. Express features include Firefly-powered Text to Image and Text Effects. Express is already being used by millions of people globally.

New AI and 3D features in Premier Pro and After Effects, including Enhance Speech and Text-Based Editing in Premier Pro and a new 3D workspace in After Effects. The Text-Based Editing feature in Premier Pro received the 2023 Hollywood Professional Association Award for Engineering Excellence.

New Lightroom mobile now integrates directly with the camera roll and introduced a streamlined interface to make editing even easy on the go.

The introduction of new video assets in Adobe Stock and strong product-led growth motions drove a record Q3 for the Stock business.

Key customer wins include Amazon, Havas, Paramount, SAP, Southern Graphics, Take-Two Interactive and U.S. Department of Energy.

As we have continued to add new applications and deliver innovations across our creative offerings, we announced price updates for certain Creative Cloud plans across the Americas and Europe, starting November 1, 2023.

In addition to being a growth driver in the Creative Cloud business, Acrobat and PDF continue to power the Document Cloud business. Whether it's a sales contract, legal document or a back-to-school form, seamless document workflows across every device and platform are more important than ever for all of us to be productive in our professional and personal lives. Document Cloud is powering document productivity and automation across the web, desktop and mobile.

In Q3, we achieved Document Cloud revenue of \$685 million, growing 15% year-over-year. We added \$132 million of net new Document Cloud ARR, with ending ARR growing 22% year-over-year in constant currency.

Business highlights include: significant growth in monthly active users across web, mobile and embedded third-party app ecosystems, reflecting our growing top of funnel and the effectiveness of our product-led growth execution; strong mobile momentum, reflecting the value of Acrobat as an essential productivity application on mobile devices; adoption of Acrobat and Acrobat Sign through increased link sharing for enhanced collaboration and approval workflows; enhanced PDF workflows across Acrobat and Express, making it seamless to create visually stunning PDFs; a new Adobe PDF Electronic Seal API, which is a cloud-based, end-to-end solution for applying electronic seals on PDFs at enterprise scale. Key customer wins include Citibank, GlaxoSmithKline, Emerson Electric, Morgan Stanley and Volkswagen.

We continue to be excited about the pending Figma acquisition, which will reimagine the future of creativity and productivity. We remain engaged with regulators and have confidence in the merits of the case.

We look forward to hosting Adobe MAX, the world's largest creativity conference, next month in Los Angeles, where we will welcome 10,000 members of our global community and engage with hundreds of thousands more online. We will hear from inspiring creators and unveil innovations across Creative Cloud, Firefly and Express.

In summary, we are excited about the pace of innovations across our Digital Media products and continued execution across multiple growth drivers.

I'll now pass it to Anil.

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**Anil S. Chakravarthy** - Adobe Inc. - President of Digital Experience Business

Thanks, David. Hello, everyone.

Every company sees digital as an opportunity to drive experience-led growth. As I've spent time with customers across the world, it's clear that they are prioritizing investments in customer experience management technology to improve customer acquisition, engagement, retention and operational efficiency. We are driving revenue growth across content and commerce, customer journeys, data insights and audiences and marketing workflows, leveraging the Adobe Experience Platform, demonstrating the strength of our business.

Brands around the globe are working with Adobe to accelerate personalization at scale through generative AI. With the announcement of Adobe GenStudio, we are revolutionizing the entire content supply chain by simplifying the creation-to-activation process with generative AI capabilities and intelligent automation. Marketers and creative teams will now be able to create and modify commercially safe content to increase the scale and speed at which experiences are delivered.

In Q3, we continued to drive strong growth in our Experience Cloud business, achieving \$1.23 billion in revenue, representing 11% year-over-year growth, as a growing number of enterprises turn to Adobe as their trusted partner for customer experience management. Subscription revenue was \$1.1 billion, representing 13% year-over-year growth.

Adobe Experience Cloud delivers predictive, personalized, real-time digital experiences, from acquisition to monetization to retention. We are driving strong enterprise adoption of Adobe Experience Platform and native apps, including Real-Time CDP, Adobe Journey Optimizer and Customer Journey Analytics.

For example, the Coca-Cola Company is leveraging Adobe Real-Time CDP and Adobe Journey Optimizer to bring together 98 million customer profiles globally into a single CDP to quickly deliver personalized campaigns and experiences. smart Europe, an all-electric automotive brand, is using Adobe Experience Cloud to offer customers the ability to personalize their vehicle purchases through the integration of Adobe Workfront, Adobe Creative Cloud and Adobe Experience Manager.

Business highlights include: strong momentum across AEP and native apps, with the total book of business surpassing \$600 million during the quarter. Adobe Journey Optimizer book of business more than doubled year-over-year as customers increasingly drive omni-channel personalization and engagement.

Continued innovation in Adobe Experience Manager with AEM assets now natively integrated with Firefly and Express, enabling any employee across an organization to generate and reuse beautiful on-brand content.

Growth of our Workfront business, reflecting our ability to serve the workflow and collaboration needs of enterprise customers and agencies. In Q3, we added Havas to the growing list of top agencies standardizing on Adobe for their content supply chain.

Expanded strategic partnership with Amazon. Given customer demand, we will jointly deliver AEP on AWS and Amazon will deploy Experience Cloud across their enterprise.

Adobe's leadership in content management systems was recognized across 3 industry analyst reports, including the IDC MarketScape for Full-stack Content Management Systems, the IDC MarketScape for Hybrid Headless CMS and the Forrester Wave for Content Management Systems. Adobe was also named a leader in the Gartner Magic Quadrant for Digital Commerce as well as the IDC MarketScape for omni-channel marketing platforms for B2C enterprises.

Key customer wins include Amazon, Blue Cross Blue Shield of Florida, Dollar General, Havas, Intuit, IRS, Jet2.com, Lufthansa, Macy's, MSC Cruises, Novo Nordisk and SAP.

These and other customers continue to prioritize investments in customer experience management solutions despite increased scrutiny of enterprise IT spend. Our solutions enable enterprises to simultaneously achieve the twin goals of driving new customer acquisition and serving existing customers to deliver profitable growth. Adobe is well positioned to keep winning with our differentiated offerings, track record of innovations and ability to drive ROI for companies across industries. We're looking forward to a strong close to the year.

I will now pass it to Dan.

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**Daniel J. Durn** - Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations

Thanks, Anil. Today, I'll start by summarizing Adobe's performance in Q3 fiscal 2023, highlighting growth drivers across our businesses, and I'll finish with financial targets.

Adobe's performance in Q3 demonstrates something that makes us exceptional, the combination of growth and profitability. In fact, at Adobe, rather than talking about the trade-offs between growth or profitability, we call it an and statement. Growth and profitability is not new for us, we have been delivering both for a very long time and is at the core of our operating philosophy. It all starts with prioritization, innovation, and a sharp focus on execution. This philosophy shines through in our Q3 results.

We're investing in technology platforms, global campaigns to attract and engage millions of customers and recruiting the best and brightest people in our industry. While doing that, Adobe is driving outperformance on margin and earnings, demonstrating what a special company we are.

In Q3, Adobe achieved revenue of \$4.89 billion, which represents 10% year-over-year growth, or 13% in constant currency. GAAP diluted earnings per share was \$3.05, up 26% year-over-year, and non-GAAP diluted earnings per share was \$4.09, up 20% year-over-year.

Other business and financial highlights included: Digital Media revenue of \$3.59 billion, net new Digital Media ARR of \$464 million, Digital Experience revenue of \$1.23 billion, cash flows from operations of \$1.87 billion, RPO of \$15.72 billion exiting the quarter, and repurchasing approximately 2.1 million shares of our stock during the quarter.

In our Digital Media segment, we achieved Q3 revenue of \$3.59 billion, which represents 11% year-over-year growth, or 14% in constant currency. We added \$464 million of net new ARR in the quarter, our strongest Q3 on record, exiting the quarter with \$14.60 billion of Digital Media ARR, growing 15% year-over-year in constant currency.

We achieved Creative revenue of \$2.91 billion, which represents 11% year-over-year growth, or 14% in constant currency. We added \$332 million of net new Creative ARR in Q3, with strong demand across our offerings.

Third quarter Creative growth drivers included: new user growth across geographies, customer segments and creative offerings driven by innovation and targeted campaigns utilizing insights from our data-driven operating model; outstanding top of funnel performance resulting from viral community excitement and success of our product-led growth strategy, driving traffic to Adobe.com; single app subscriptions for Photoshop driven by interest in the magic of Firefly, Generative Fill and Generative Expand; another great quarter for value-added services, including strong customer demand for Adobe Stock; continued customer adoption of Acrobat CC; strong engagement and retention across customer segments; and success in the enterprise driven by transformational ETLAs that span the entire Creative portfolio, including CC All Apps for creative teams, Express for knowledge workers, Frame for collaboration and Adobe Stock and Firefly for content.

Adobe achieved Document Cloud revenue of \$685 million, which represents 13% year-over-year growth, or 15% in constant currency, and we added \$132 million of net new Document Cloud ARR in the quarter.

Third quarter Document Cloud growth drivers included: success with new customer acquisition through our Reader and Acrobat web funnels and distribution partners, with monthly active users up over 70% year-over-year for Acrobat Web; strong demand for Acrobat subscriptions across customer segments and geographies, driven by targeted offers; strength in monetization from Acrobat mobile, which grew ending ARR over 30% year-over-year in constant currency, driven by product innovation and conversion; and traction in B2B with strong unit demand for our Team offering through the reseller and direct routes to market.

Turning to our Digital Experience segment. In Q3, we achieved revenue of \$1.23 billion, which represents 10% year-over-year growth, or 11% in constant currency. Q3 subscription revenue was \$1.10 billion, which represents 12% year-over-year growth, or 13% in constant currency.

Third quarter Digital Experience growth drivers included: demand for our Adobe Experience Platform and native applications, including Real-Time CDP, Customer Journey Analytics and Adobe Journey Optimizer. In Q3, subscription revenue for AEP and apps grew 60% year-over-year; strength in content and commerce, with Adobe Experience Manager continuing to set the standard for enterprise content management; growth of our Workfront business as workflow and collaboration are essential components of an enterprise content supply chain solution; strong retention rates in the quarter as we continue to focus on value realization to our Digital Experience customers; and continued momentum in transformational platform deals with large enterprises adopting our end-to-end suite of applications.

Adobe's effective tax rate in Q3 was 19.5% on a GAAP basis and 18.5% on a non-GAAP basis. The GAAP tax rate came in lower than expected due to tax benefits associated with the vesting of share-based payments in the quarter.

RPO exiting the quarter was \$15.72 billion, growing 11% year-over-year, or 13% when adjusting for a 2% FX headwind.

Our ending cash and short-term investment position exiting Q3 was \$7.52 billion, and cash flows from operations in the quarter were \$1.87 billion.

In Q3, we entered into a \$1 billion share repurchase agreement, and we currently have \$3.15 billion remaining of our \$15 billion authorization granted in December 2020.

Factoring in current macroeconomic conditions and year-end seasonal strength, for Q4, we're targeting total Adobe revenue of \$4.975 billion to \$5.025 billion; Digital Media net new ARR of approximately \$520 million; Digital Media segment revenue of \$3.67 billion to \$3.70 billion; Digital Experience segment revenue of \$1.25 billion to \$1.27 billion; Digital Experience subscription revenue of \$1.11 billion to \$1.13 billion; tax rate of approximately 18% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of \$3.10 to \$3.15; and non-GAAP earnings per share of \$4.10 to \$4.15.

Q3 was a great quarter for Adobe, and I couldn't be more pleased with how the company is positioned to continue to deliver for our customers and investors. We're looking forward to our investor meeting at Adobe Max on October 10, where we'll do a deep dive into our AI innovation. I hope to see you there.

Shantanu, back to you.

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**Shantanu Narayen** - Adobe Inc. - Chairman & CEO

Thanks, Dan. Adobe's strong Q3 results are a reflection of our team's exceptional execution.

We recently lost our beloved co-founder, John Warnock. John's brilliance and innovations changed the world. He was one of the greatest inventors of our generation and an inspiration to the technology industry. While we miss him tremendously, it gives me great comfort knowing that John was so proud of all the innovation Adobe continues to deliver.

As someone who shares John's passion for product and innovation, I'm exceptionally energized by the technology platforms we are delivering with AI at the center across our 3 clouds to delight customers.

Our brand, technology and our talented employees position us for a strong close to the year and continued growth in the decades to come. Adobe's best days are ahead of us.

Thank you. We will now take questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And our first question will come from Keith Weiss with Morgan Stanley.

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### Keith Weiss - Morgan Stanley, Research Division - Equity Analyst

A really nice quarter. Dan, actually, a margin question for you and kind of a riddle that like we've been thinking about. We've been told generative AI is really expensive to run. The inference and training costs are really high. You guys have been running a beta for a while, 2 million images generated. There's a lot of functionality already in the product. And your operating margins are up. Your gross margins are up on a year-on-year basis. So how are you able to do that? Like, where are these costs going, if you will? And on a go-forward basis, as all this stuff becomes generally available, how should we think about that gross margin impact or the overall margin impact of generative AI on a go-forward basis?

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### Daniel J. Durn - Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations

Yes. Thanks, Keith. So as you rightfully point out, the engine of innovation at the company is really strong. A lot of exciting announcements this week. But we've been at this now a year, bringing the magic of generative AI and Firefly to life. And we're just getting started from an innovation standpoint. Over the last 6 months, we've been live with the beta. And as you point out, we've generated -- our customers have generated over 2 billion images. And I know it's not lost on people, all this was done while we're delivering strong margins.

But when we take a step back and think about these technologies, we have investments from a COGS standpoint, inferencing, content; from an R&D standpoint, training, creating foundation models. And David alluded to it in his prepared comments, the image model for Firefly family of models is out, but we're going to bring other media types to market as well so we're making substantive investments.

When I go back to the framing of my prepared comments, we really have a fundamental operating philosophy that's been alive at the company for a long time: growth and profitability. We're going to prioritize, we're going to innovate and we're going to execute with rigor. And you see that coming through in all of the financial results of the company.

As we think about going -- the profile going forward, what I'll come back to is when we initially set fiscal 2023 targets, implicit in those targets was a 44.5% operating margin. If you think about how we just guided Q4, where we've got these 4 great new products and these technologies infused into the product lineup and all of the support we're going to do as we roll these out at our MAX conference down in L.A., again, to keep the enthusiasm with the customer base building, implicit in that guide is an operating margin of around 45.5%.

So as you think about us leading this industry, leading the inflection that's unfolding in front of us, that mid-40s number, we think, is the right ballpark to think about the margin structure of the company as we continue to drive this technology and leadership. Looking forward to the Q4 earnings call where we will share more about our fiscal 2024 targets.



**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

And maybe, Keith, just 30 seconds to add to that, for investors like you who want to make sure we're not -- in any way not investing in the future, we are investing on training for 3D, for video, for new forms of imaging and vectors. So what we are confident is, while we continue to invest in that, the scrutiny that Dan and his team have on other expenses, that we can continue to drive top line growth as well as cash flow and EPS. So I think we're unique in that respect.

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**Keith Weiss** - *Morgan Stanley, Research Division - Equity Analyst*

Definitely. Very impressive, guys.

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**Operator**

And our next question will come from Kash Rangan with Goldman Sachs.

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**Kasthuri Gopalan Rangan** - *Goldman Sachs Group, Inc., Research Division - Head of Software Coverage*

Sorry to hear of John Warnock's passing. My condolences. But congrats on the quarter. As we look at the pricing model for generative AI products, which are based on consumption, do you think that these -- rather how additive do you think the generative AI offerings will be to the growth profile of the company going forward?

And also one for Dan, when you look at your Q4 guidance, are you contemplating -- it looks like it's not largely changed versus the Street's prior expectations. Are we not embedding any opportunities to show what the generative AI products can do? Because they seem to be largely incremental to what had been contemplated when you first gave guidance fall of last year.

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

Kash, maybe David and I can take the first parts of the question. And just again, for everybody on the call, I think to summarize the new offerings that we have, we've announced that we have a Firefly subscription. So you can use a free trial number of credits, and after that, you can actually subscribe to Firefly. We have Adobe Express, which now includes an allocation of Firefly. We certainly have the Creative Cloud products and Photoshop and Illustrator that have it. We have generation credit packs, and we have GenStudio for the enterprise and to be able to deal with it. So first, I just wanted to make sure that you recognize the tremendous innovation that we're delivering associated with that.

And as you know, one of the things that we have done is to really focus on both new user acquisition, which is going to be driven across all of those offerings, as well as with the price increase, given there is an allocation associated with it for existing customers, they will start to see that as they roll over and they have to renew their subscription.

So I just wanted to set that bit, and maybe then I'll ask David to add a little bit about each of these and how we see that play out.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Yes. Thanks, Shantanu. Yes, Shantanu said that we look at the business implications of this through those two lenses: new user adoption, first and foremost; and then sort of opportunity to continue to grow the existing book of business. On the new user side, we've said this for years: our focus continues to be on proliferation. We believe that there -- we have a massive number of users in front of us. We continue to have our primary focus being net user adds and subscribers. And so the goal here in proliferation is to get the right value to the right audience at the right price.

And if I think about the 4 new offerings that Shantanu teed up, I think 2 of them are primed to maybe be on the earlier side of that. First, on the individual side, Express. It's been in the market for over a year now. And the new release of Express is a massive step forward in terms of the abilities that it has, both -- everything from performance to support for a broader set of things beyond design into video and into illustration, into PDF and document workflows. So there's just a tremendous amount of new value that we've added, including generative AI into that. So we think that Express will be an early indicator of that success that we're talking about.

The second one is the work that we're doing in the DME business in conjunction with Anil and the DX business around enterprises, so GenStudio, and enabling the broad base of marketers to actually use Express in conjunction with the Creative Studio teams using Creative Cloud to really accelerate their use of and creation of content. So that really, in the context of the short-term contributors, we think that will be really meaningful. We also expect that we -- as we do this and drive new users, we expect to see a lot of new users come into the free plans, and that's going to take a little time to ramp. We'll bring them into the Adobe family, get them using the products and ramp them to greater value over time. So first and foremost, proliferation on new users.

The second thing is going to be on the book of business. And here, we're -- basically, the pricing changes, just as a reminder, they have a rolling impact. We're going to start them late in Q4, and it will -- we're going to start it in certain geos only. And then we're going to have a measured rollout in new countries over the course of the next couple of years.

And then certainly also as it relates to enterprise customers, the renewal timing will probably take about 3 years given the multiyear contracts that we have in place. So net-net, we see this truly as a seminal moment for how we're going to grow the business, but it's going to take a few years to play out, and we're really excited about sort of what this means for bringing new customers into the franchise.

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

And maybe, Kash, just to then tie that all together, in terms of the numbers that we've given for Digital Media ARR, because you asked the question from the beginning of the year, remember, I think we guided to \$1.65 billion. If you look at what it is, even with our Q4 guide that I think \$200 million more than that, \$1.86 billion or something to that effect and since we guided in Q3 -- for Q3 and Q4 \$100 million. So we continue to be really confident and we're excited about the road map.

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**Operator**

And our next question will come from Saket Kalia with Barclays.

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**Saket Kalia** - *Barclays Bank PLC, Research Division - Senior Analyst*

Congrats on a great quarter and outlook. Anil, actually my question is for you. Obviously, a lot to talk about with Firefly in the Digital Media business, and it's very clearly a revenue opportunity there. I'm wondering what -- how you think about the generative AI road map or revenue opportunity in the Digital Experience part of the business. I know we talked about the content supply chain, but how do you think about the future of generative AI in your business?

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**Anil S. Chakravarthy** - *Adobe Inc. - President of Digital Experience Business*

Yes. Thanks, Saket. Shantanu and David already talked about the Adobe GenStudio, and we're really excited about that. This is a unique opportunity, as you said, for enterprises to really create personalized content and drive efficiencies as well through automation and efficiency. And when you look at the entire chain of what enterprises go through from content creation, production workflow and then activation through DX through all the apps we have on our platform, we have the unique opportunity to do that. We already have deployed it within Adobe for our own Photoshop campaign, and we're working with a number of agencies and customers to do that. So this is a big net new opportunity for us with Adobe GenStudio.

We're also working on generative AI for other DX applications as well. And at the investor meeting in October, we'll share more details. But we see a similar opportunity with generative AI to bring together the ability for a number of users across marketing departments organizations to be able to use the Adobe Experience platform and apps, and it will act as a copilot to accelerate the use cases that they bring to life. So we'll share more about that at the investor meeting.

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

Saket, maybe just to give Anil and the team a lot of credit for what they actually accomplished in Q3 as well. The wins in Q3 in the Enterprise actually included a lot of the components of GenStudio, both in the Digital Media as well as in the Digital Experience. So certainly, the transformational deals that we're talking about, a big part of that is the synergy between the 2 clouds. So I wanted to point that out as well.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

And if I could actually just add one quick thing at the GenStudio work that Anil team has been doing, we've actually been using that within the Digital Media business already to release some of the campaigns that we've released this quarter. So it's one of these things that it's great to see the impact it's having on our business and that becomes a selling point for other businesses, too.

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**Operator**

And moving on to Gregg Moskowitz with Mizuho.

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**Gregg Steven Moskowitz** - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Congratulations as well on a strong quarter. So when I look at Firefly, the amount of image generation in a 6-month period is clearly pretty stunning. And I'm just wondering if you're able to provide any additional color, whether it be monthly active users or some other metric, that may additionally help all of us gauge the improvements that Firefly is driving to your engagement levels, to your top of funnel, et cetera.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Yes. Happy to talk about that. It's been a remarkable few months. I mean, we've said a few things. First is that the viral excitement that we saw because of Firefly on social has been hugely beneficial, and it's certainly driven a lot of top-of-funnel opportunity for us. In addition to that, one of the things that we were very excited about is when we integrated it into our Creative Pro applications, Illustrator and Photoshop primarily, we saw over 3 million downloads of those betas, beta applications, which is something we've never seen before. That gives you a sense of like how thirsty the existing customer base is for the generative capabilities that we have as well.

And lastly, one of the things that we're very excited about and we obviously track very carefully is what does this do in terms of giving us access to new users that don't typically come to Adobe. And both Express and Firefly, and in particular, the integration of Firefly and Express, has been a real accelerant to that. So it's been nice to see us not just getting excitement within the current base but seeing millions of other users coming in that would not have typically come to Adobe for a product and then giving -- and starting their journey with Adobe through Firefly and Express.

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

Two other maybe financial indicators to that, Gregg, are first, the Photoshop Single App, and I think Dan referred to that. Even in the beta, that actually drove a lot of Photoshop Single App, and the early indicators of how that also benefits retention in the entire book of business. So both of those are also good financial indicators of the potential of AI.

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**Operator**

And we have a question from Brad Sills with Bank of America.

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**Bradley Hartwell Sills** - *BofA Securities, Research Division - Director, Analyst*

Wonderful. I wanted to ask about a comment that I think David made earlier in the call, where you're working hard to make Firefly the option for content design to be safe. I would love to double-click on that and understand a little bit how is Adobe the safe option and how is the company making this Firefly in this new generative frontier the safe option for enterprises.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Yes. So from the very beginning of Firefly, we took a very different approach to how we were doing generative. We started by looking at and working off the Adobe Stock base, which are contents that are licensed and very clearly we have the rights to use. And we looked at other repositories of content where they didn't have any restrictions on usage, and we've pulled that in. So everything that we've trained on has gone through some form of moderation and has been cleared by our own legal teams for use in training. And what that means is that the content that we generate is, by definition, content that isn't then stepping on anyone else's brand and/or leveraging content that wasn't intended to be used in this way. So that's the foundation of what we've done.

We've gone further than that, of course. And we've now actually -- we've been working with our Stock contributors. We've announced, and in fact, yesterday, we had our first payout of contributions to contributors that have been participating and adding stock for the AI training. And we're able to leverage that base very effectively so that if we see that we need additional training content, we can put a call to action, call for content, out to them, and they're able to bring content to Adobe in a fully licensed way. So for example, earlier this quarter, we decided that we needed 1 million new images of crowd scenes. And so we put a call to action out. We were able to gather that content in. But it's fully licensed and fully moderated in terms of what comes in. So as a result, all of the content we generate is safe for commercial use.

The second thing is that because of that, we're able to go to market and also indemnify customers in terms of how they're actually leveraging that content and using it for content that's being generated. And so enterprise customers find that to be very important as we bring that in not just in the context of Firefly stand-alone but we integrated into our Creative Cloud applications and Express applications as well. So the whole ecosystem has been built on that.

And the last thing I'll say is we've been very focused on fair generation. So we look intentionally for diversity of people that are generated, and we're looking to make sure that the content we generate doesn't create or cause any harm. And all of those things are really good business decisions and differentiate us from others.

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**Operator**

And we have a question from Keith Bachman with BMO Capital Markets.

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**Keith Frances Bachman** - *BMO Capital Markets Equity Research - Research Analyst*

Yes. I want to go back -- David, I wanted to hear your perspective on kind of the third cloud, the Document Cloud, if you will, as we look out over the next 12 months. And the spirit of the question is, there's a lot of attention, appropriately so, given Firefly and whatnot and perhaps even lending itself in the Experience Cloud. But does gen AI provide any tailwinds associated with the Document Cloud? Or is it sort of the existing driver that will help contribute to growth as we look at next year? But any just kind of -- what are the key things that we should be thinking about for Document Cloud?

**David Wadhvani** - Adobe Inc. - President of Digital Media Business

Yes. First of all, we are very happy with the quarter Doc Cloud had. The ending book of business grew 22% in constant currency. And the strength of that is really driven based on top of funnel growth, right? So Acrobat on the Web had a phenomenal year-over-year growth rate. We've been working very actively to get Acrobat sort of deployed within -- as plug-ins within the browsers. We've got a great -- we've been doing a lot of product-led growth work in the products themselves to drive link sharing so that more and more people are not just using our products, but as they share links, we're actually able to capture more people and build growth loops. Signatures has been also doing incredibly well.

So as we've got this broad-based proliferation of our surfaces that are available and continue to grow in terms of both free and paid usage, it creates a surface area that we can introduce a lot of really interesting things into. We haven't announced anything publicly associated with gen AI directly inside of Acrobat. But I think you can fairly safely expect to hear more about that from us soon.

And what makes gen AI particularly interesting as it relates to Acrobat is the distribution that we have with Acrobat. So if Acrobat is -- and Reader are in front of hundreds of millions of people on a monthly basis, our ability to insert generative AI into their workflows, just like we've been able to really differentiate our work on generative AI in creative by inserting it into the workflows of creative folks, I think that becomes the secret sauce to how we differentiate ourselves.

**Operator**

And our next question will come from Brent Thill with Jefferies.

**Brent John Thill** - Jefferies LLC, Research Division - Equity Analyst

Shantanu, you mentioned success in ETLAs. What's driving that, especially given some of the macro jitters that are still lingering? Are you starting to see those jitters go away and that's the result of what's happening with the ETLAs?

**Shantanu Narayen** - Adobe Inc. - Chairman & CEO

I think in the ETLA specifically, Brent, both to the comments that David and Anil mentioned, the first is the amount of content that people are creating. There's a lot of interest associated with ensuring that the combination of Creative Cloud plus Express, that people can really understand what they are spending on their content as well as find ways to use AI to automate it, to localize it, to improve production costs. So I think that message is certainly resonating with people and the fact that Express can be a productivity application for every knowledge worker in the enterprise, much like Acrobat as well. So I think both of those are really leading to a significant amount of great conversations.

I think mobile, David perhaps mentioned even in his prepared remarks how mobile has been one of the tailwinds that we've seen, Brent. So I think that's also working. So I think investment in productivity gains is clearly top of mind right now, and both of these play well into that narrative in enterprises.

**Operator**

And we have a question from Alex Zukin with Wolfe Research.

**Aleksandr J. Zukin** - Wolfe Research, LLC - MD & Head of the Software Group

And I guess a two-parter on generative AI. First, just around the pricing model for generative credits. Obviously, very progressive. And I guess, how should we think about -- as we go forward and you've seen at least on the hobbyist side some of the usage of Firefly and within Express, how do

we think about for the 2 cohorts of both obvious and professional creatives, how many credits are kind of a typical user or use case likely to drive in a given month?

And to the question that you got kind of about Document Cloud and the impact of generative AI on that business, is it fair to think that given the pricing that's been announced, the next wave of incremental innovation, is that going to come more from new product availability? Or should we think about more pricing-enabled levers to come?

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**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

I think Alex, on the first question associated with how did we think about pricing, I mean, first, it's important to remember the breadth of all of the segments that we serve, in other words, how we think about K-12 all the way to the largest enterprise in the world. And I think it's fair to say that philosophically, we wanted to drive more adoption, and therefore, the pricing as it relates to what's included in the at least short run for Firefly subscriptions, Express subscriptions, GenStudio in terms of how much they can get within an enterprise is going to be the bulk of how we recognize the ARR. And I think getting that adoption and usage is where the primary focus is going to be in terms of the new user adoption as well as, for existing customers, the pricing upgrade. So that's how we think about it.

We certainly need the ability to have the generative packs but I think just getting everybody exposed to it. One of the real innovations that we did that's driven tremendous uptake in that is what we've called this context of where sort of menus within Photoshop. So it's so front and center. You'll start to see that being rolled out in all of the other applications. So that's sort of the focus. Let's get the core subscriptions. Let's get all of them exposed to it, and let's make sure that we're covering what we need to buy the pricing actions that we took. So that was sort of the focus.

I think on the Doc Cloud part and how we look at it, to add to, again, what David said, I mean some of the things that people really want to know is how can I have a conversational interface with the PDF that I have, not just the PDF that I have opened right now but the PDF that are all across my folder, then across my entire enterprise knowledge management system, and then across the entire universe. So much like we are doing in Creative, where you can start to upload your images to get -- train your own models within an enterprise, well, it is often [hard-pressed].

The number of customers who want to talk to us now that we've sort of designed this to be commercially safe and say, "Hey, how do we create our own model," whether you're a Coke or whether you're a Nike, think of them as having that. I think in the document space, the same interest will happen, which is we have all our knowledge within an enterprise associated with PDFs, "Adobe, help me understand how your AI can start to deliver services like that." So I think that's the way you should also look at the PDF opportunity that exists, just more people taking advantage of the trillions of PDFs that are out there in the world and being able to do things.

The last thing maybe I'll mention on this front, Alex, is the APIs. So part of what we are also doing with PDFs is the fact that you can have all of this now accessible through APIs. It's not just the context of the PDF, the semantic understanding of that to do specific workflows, we're starting to enable all of that as well. So hopefully, that gives you some flavor. You're right, the generative credits has been designed to more for adoption right now. But we also wanted to make sure that at the high end, we were careful about how much generative credits we allowed.

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Yes. And just one thing to add to that, Alex, is that one of the things we did -- first of all, it was a very thoughtful, deliberate decision to go with the generative credit model. And the limits, as you can imagine, were very, very considered in terms of how we set them. The limits are, of course, fairly low for free users. The goal there is to give them a flavor of it and then help them convert. .

And for paid users, especially for people in our Single Apps and All Apps plans, one of the things we really intended to do is try and drive real proliferation of the usage. We didn't want there to be generation anxiety, put in that way. We wanted them to use the product. We wanted the Generative Fill and Generative Expand. We wanted the vector creation. We want to build the habits of using it. And then what will happen over time as we introduce 3D, as we introduce video and design and vectors, and as we introduce these Acrobat capabilities that Shantanu was talking

about, the generative credits that are used in any given month continues to go up because they're getting more value out of it. And so that's the key thing. We want people to just start using it very actively right now and build those habits.

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**Aleksandr J. Zukin** - *Wolfe Research, LLC - MD & Head of the Software Group*

Super clear. Super thoughtful. If I could sneak one in for Dan. Of the \$520 million in the net new ARR for Q4, just roughly, you've talked about before having some impact from the generative AI products that you were going to launch this year. Is it fair to assume it's very minimal in that \$520 million?

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**Daniel J. Durn** - *Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations*

Yes, I would say it's a modest impact to the business in Q4. And again, a quarter from now when we give our FY 2024 targets, we'll have more to say of what that looks like going forward, but modest impact in Q4.

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**Operator**

And we'll take a question from Brad Zelnick with Deutsche Bank.

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**Brad Alan Zelnick** - *Deutsche Bank AG, Research Division - Head of Software Equity Research and Senior US Software Research Analyst*

David, you talked about making Firefly APIs available to customers to embed Firefly into their own content creation workflows. Can you talk about the use cases and monetization? And is this something you foresee partners leveraging as well into their own third-party offerings?

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**David Wadhvani** - *Adobe Inc. - President of Digital Media Business*

Yes, absolutely. Our goal right now, for enterprises and third-parties that we work with, is to provide a few things. The first is this ability, obviously, to have API access to everything that we are building in, so that they can build it into their workflows and their automation stack.

The second thing is to give them the ability to extend or train their own models as well. So if -- as we mentioned earlier, our core model, foundation model is a very clean model. It generates great content and you can rely on it commercially. We want our customers and partners to be able to extend that model with content that is relevant to them so that Firefly is able to generate content in their brand or in their style. So we'll give them the ability to train their own model as well.

And then last, but certainly not least, we'll give them some core workflows that will work with our existing products, whether it's Express or whether it's Creative Cloud or GenStudio as well, so that they can then integrate everything they're doing onto our core platform.

And then from a monetization perspective, you can imagine the metering concepts that we have for generative credits extending to API calls as well. And of course, those will all be custom negotiated deals with partners and enterprises.

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**Jonathan Vaas** - *Adobe Inc. - VP of IR*

Operator, we're getting close to the top of the hour. We'll take one more question, please.

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**Operator**

Our next question will come from Jay Vleeschhouwer with Griffin Securities.

**Jay Vleeschhouwer** - *Griffin Securities, Inc., Research Division - MD of Software Research*

Shantanu, over the last decade or more, one of the most important attributes of how you've managed your product portfolio have been the intra-segment and intersegment integrations, particularly between Digital Media and DX. There was, as you know, a famous acronym for that.

Now when we think about the current generation of integrations that you've just announced, including yesterday, aside from the Firefly-ing of the product line and the proliferation of Firefly, what are some of the internal developmental changes that you yourselves have had to make in order to support the development of new integrations, new packaging? What are you doing differently internally? And then externally, particularly to support the new generation of products, what are you having to invest in, in terms of customer support and enabling their adoption?

**Shantanu Narayen** - *Adobe Inc. - Chairman & CEO*

Yes, Jay, I mean -- and certainly, I think at MAX also, you'll see a bunch more of the innovation. I think first, internally, I'd be remiss if I didn't start off by saying how really thrilled I am with how quickly the company has embraced the possibilities of AI, how we run all of these betas out there at a scale that, as we have said, is unprecedented, dealing with the differentiation that we can provide, whether that's how we deal with the data, understanding the indemnification, how we embed all of this AI stuff in the interfaces. And we've already shown that in Photoshop, Illustrator, Express as well as create the new offering.

So I think the pace of innovation internally of what we have done is actually truly amazing. I mean relative to a lot of the companies that are out there and the fact that we've gone from talking about this to very, very quickly, making it commercially available, I don't want to take for granted the amount of work that went into that. I think internally, it is really galvanized because we are our own biggest user of these technologies.

What we are doing associated with the campaigns and the GenStudio that we are using, as David alluded to it, our Photoshop Everyone Can Campaign or the Acrobat's Got It campaign or how we will be further delivering campaigns for Express as well as for Firefly, all of this is built on this technology. And we use Express every day, much like we use Acrobat every day. So I think it's really enabled us to say are we really embracing all of this technology within the company.

And that's been a big change because I think the Creative products, we've certainly had phenomenal usage within the company, but the extent to which the 30,000 employees can now use our combined offering, that is very, very different internally. So very pleased, associated with that. And I think one way in which that manifests is that all of our product reviews right now include all 3 groups. So there's very little product sort of reviews that happen without people from Creative and Document and the Experience Cloud being part of it. So that's one of them.

I think the work that we have already put in on the digital excellence as part of DDOM, that also gives us a lot of confidence of now that we have this breadth of offering, how do we make sure that we can personalize the offerings. Part of the success that was driven in this quarter, Jay, was to do with the fact that the stock and these value-added services, I think the digital excellence team in terms of the DDOM have really got very good at segmenting our customers and understanding how we can make sure that they have the right offering. And now think of that with all of the breadth of offerings that we have across mobile and desktop and Web. So I think internally and externally, this has been, again, a real sort of drinking from the firehose of how we embrace AI. And so I think those are really 2 examples of how we've done it.

And the third thing I would say is that in parallel, internally, we've had to really change, where prior to this, Jay, we may have said, "Okay, we're really going to make all of this magic happen in one of our applications." Today, that has to happen not just within the application, which we've certainly done, but it has to happen as an API so that everybody else can use it. It has to happen as a Web-only playground, which is what Firefly and Express both has. So the simultaneous release of not just investing in the model but making sure that's available across all the surfaces, I would say that's another thing.

And the last thing I'll leave you with is you've seen this for imaging. Make no mistake, those same investments, whether it's in vector or animation or 3D, all of those video certainly are underway. And so I think the parallelism associated with saying how do we embrace this opportunity, I think that's also been another big change.



But I think it's clear, given this was the last question before I hand it over to Jonathan, that a lot of the questions have been focused on understanding right now all of our announcements and the monetization associated with it. But I did want to again sort of acknowledge that we have delivered all of this innovation at a breakthrough pace. And so we'll certainly share more as it relates to how we see this play out at MAX, you'll see us have more information on the products. And certainly with the 2024 targets, you'll start to get more visibility into how and why we believe this is both a growth opportunity as well as embracing new customers.

So thank you for joining us. And with that, I will turn it back over to Jonathan.

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**Jonathan Vaas** - Adobe Inc. - VP of IR

Thanks, Shantanu, and thanks, everyone, for joining us today. Looking ahead, we have an exciting lineup planned for MAX starting on October 10, and we hope you'll be able to attend the entire conference. At the investor meeting after the day 1 keynote, we plan to focus on the impact of AI across our customer offerings with previews into our technology road map and how these innovations expand Adobe's reach.

Given that, fiscal 2024 targets will be provided at our December earnings call. In addition, we're planning another investor event at Adobe Summit in March to give more insight into our addressable markets and financial performance. We hope to see you there.

Thanks, everyone, and this concludes the call.

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**Operator**

That does conclude today's conference. We do thank you for your participation. Have an excellent day.

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